Three-Year General Fund Financial Outlook

FY 2017-18 to FY 2019-20

Prepared Pursuant to Act 156 of 2005

§11-11-350

South Carolina Revenue and Fiscal Affairs Office

December 2016

Three-Year General Fund Financial Outlook
FY 2017-18 to FY 2019-20
Based on Enacted FY 2016-17 Budget
(Dollars in Millions)

	FY 2016-17 "Base Year"	Projections FY 2017-18	FY 2018-19	FY 2019-20
Resources:				
Beginning Balance		$0.0	$28.1	$308.4
Revenue (BEA Long Range Revenue Forecast, 11/10/2016)	8,157.5	8,470.6	8,873.6	9,242.3
Adjustments				
Tax Relief Trust Fund Transfers	(578.0)	(583.7)	(592.1)	(600.7)
General Reserve Fund Transfer		(15.5)	(15.4)	(15.4)
Total Revenue/Resources	**$7,579.5**	**$7,886.9**	**$8,309.6**	**$8,950.0**
Expenditures and Reserve Fund Contributions:				
Baseline (Adjusted Recurring Budget)	**$7,579.5**	**$7,579.5**	**$7,579.5**	**$7,579.5**
Constitutional/ Statutory Items:				
Reserve Funds: Capital Reserve (CRF)		6.2	12.4	18.5
Local Government Fund		10.6	10.6	10.6
Debt Service		(84.8)	(103.8)	(112.0)
Homestead Exemption Fund Shortfall (Act 388 of 2006)		(17.3)	(32.9)	(49.2)
Aid to Fire Districts		3.0	3.0	3.0
Major Expenditure Categories:				
K-12 Education		61.2	129.9	202.2
Medicaid and Health (net of earmarked cigarette tax revenue)		57.8	109.0	179.3
Social Services		44.7	44.7	44.7
Higher Education Scholarship Growth (LIFE, HOPE & Palmetto Fellows)		21.1	35.6	48.4
State Employee Health Plan - Retiree Growth + Rate Increase		26.5	90.4	190.8
State Employee Compensation Changes (2% Per Year)		36.4	72.8	109.2
DOT Non-federal Highway Fund		50.0	50.0	50.0
Hurricane Matthew Response and Recovery		64.0	0.0	0.0
Total Expenditures	**$7,579.5**	**$7,858.8**	**$8,001.1**	**$8,275.1**
Ending Balance	$0.0	$28.1	$308.4	$675.0
Projected CRF Funds Available for Nonrecurring Expenditures		$139.2	$145.4	$151.6
Projected General Reserve Fund Balance	$348.0	$363.5	$378.9	$394.3

The Notes and Assumptions are an integral part of this Financial Outlook.

Notes

The three-year General Fund Outlook is prepared by the South Carolina Revenue and Fiscal Affairs Office in consultation with the Board of Economic Advisors in accordance with Section 11-11-350 of the S. C. Code of Laws, 1976. The Outlook is a three-year revenue and spending projection based on the enacted FY 2016-17 General Fund operating budget.

The spending projections are cumulative and the estimates are based on the FY 2016-17 enacted budget and major expenditure categories contained therein. Unless noted below, future years do not include any increases over the baseline expenditures (FY 2016-17 enacted recurring budget). If the projected balance is negative in any year, a budget gap exists. A budget gap reflects a structural imbalance between projected revenue growth and expenditure increases based on the adjusted enacted budget.

This document is intended to be used for planning purposes only and should not be viewed as requiring that the major expenditure items listed must be funded by the General Assembly. The Outlook does not attempt to capture every agency's needs or budget requests.

Resource/Revenue Assumptions

- The beginning balance for each fiscal year equals the ending balance of the prior fiscal year (difference between Revenue and Expenditures). If the balance for the prior fiscal year is less than zero, the beginning balance for the next fiscal year is assumed to be zero.

- **Board of Economic Advisors Forecast** – The Board of Economic Advisors (BEA) long-range General Fund revenue forecast is based upon its November 10, 2016 forecast for FY 2017-18. The FY 2017-18 revenue estimate serves as the base for the long-range forecast. The plan is built upon an assumed growth rate in personal income, historical elasticities for the major revenue components (sales and individual income taxes), and historical growth rates or patterns in the remaining revenue sources.

  The assumptions and methodologies for this long range forecast include:

  - An annual personal income growth rate of 4.75%;
  - A sales tax growth rate of 4.75% based on a historical elasticity of 1.0;
  - An individual income tax growth rate of 5.23% based on a historical elasticity of 1.1;
  - Corporate income tax first declining, then holding steady throughout the forecast period; and
  - Historical trends and patterns and other legislative factors affecting the remaining revenues.

  The annual growth rates for FY 2017-18, FY 2018-19, and FY 2019-20 are 3.8%, 4.8%, and 4.2%, respectively. The detailed three-year General Fund revenue forecast by revenue category is included as an attachment to this document.

- **Tobacco Master Settlement Agreement** – The state's "tobacco bonds," securitized by its Tobacco Master Settlement Agreement (MSA) payments, were retired June 1, 2012. By statute, future MSA receipts are available for appropriation. The revenue expected, based on historical MSA payments to the state and settlement credits, is estimated at $70.0 million annually. Current statute earmarks these funds primarily for healthcare programs; however, specific program appropriations is at the discretion of the General Assembly. For FY 2017-18 through FY

2019-20, $70.0 million is estimated to be available for appropriation annually, but is not shown as additional revenue in the Outlook as it was appropriated in the base year.

RESERVE FUNDS

- **General Reserve Fund –** On November 2, 2010, a constitutional amendment was adopted increasing the General Reserve Fund from three percent to five percent. Currently, the General Reserve Fund is fully funded at $348 million. Annual contributions for FY 2017-18 through FY 2019-20 are $15.5 million, $15.4 million, and $15.4 million, respectively, with the fund maintaining five percent funding for all years.

- **Capital Reserve Fund –** The Capital Reserve Fund (CRF) is used to offset year end deficits and to replenish, when needed, the required amount in the General Reserve Fund. If not needed to offset a year end deficit or to replenish the General Reserve Fund, the CRF may be appropriated for the following purposes: (1) to finance in cash previously authorized capital improvement bond projects, (2) to retire the interest or principal on bonds previously issued, or (3) for capital improvements or other non-recurring purposes.

Expenditure Assumptions

LOCAL GOVERNMENT FUND

- The Local Government Fund is a statutorily defined transfer of funds to counties and municipalities equal to four and one-half percent of General Fund revenues of the latest completed fiscal year. For the last eight years, the requirement to fund this account at the defined four and one-half percent level has been suspended. This report assumes funding at FY 2016-17 levels with an annualization of $10.6 million of non-recurring funds. Annual increases for FY 2017-18 through FY 2019-20 are $10.6 million, $0.0 million and $0.0 million, respectively. **However, if funding were returned to statutorily mandated levels in FY 2017-18, it would require an additional $103.9 million (total of $114.6 million).**

DEBT SERVICE

- Future Debt Service needs will decline over the forecast period. Incremental adjustments are $(84.8) million in FY 2017-18, $(18.9) million in FY 2018-19 and $(8.1) million in FY 2019-20. Estimate reflects existing law and does not include potential impact of proposed legislation.

AID TO FIRE DISTRICTS

- Appropriations for Aid to Fire Districts in the base budget have fallen short of the funding amount required by statute. Recurring appropriations of $3 million are needed to bring the funding level into compliance with the current statute.

HOMESTEAD EXEMPTION FUND

- The Property Tax Reform Act, Act No. 388 of 2006, eliminated all school operating taxes on owner-occupied homes and increased the state sales tax by one cent to replace the reduced property tax revenue stream. The new revenue from the one-cent sales tax increase is earmarked for the Homestead Exemption Fund, which replaces lost property taxes as of FY 2007-08. Funding to school districts in the first year was based on what would have been collected under the old system. For subsequent years, the school district funding requirement is based on inflation plus population growth factors. The Act provides that should there be a shortfall of revenue in the Homestead Exemption Fund the General Fund will pay the difference.

- The FY 2016-17 base budget includes $49.2 million dedicated to offset this shortfall. Due to growth in sales tax revenue, the general fund shortfall will be eliminated by the end of the forecast period. Incremental adjustments for FY 2017-18, FY 2018-19, and FY 2019-20 are $(17.3), $(15.6), and $(17.3) million, respectively.

K-12 EDUCATION

- **Education Finance Act (EFA)** – The FY 2016-17 Base Student Cost is $2,409 based on the August 2016, 135-day Weighted Pupil Unit count of 974,655. This forecast assumes a 2.3% inflation factor for FY 2017-18 and 2.5% for FY 2018-19 and FY 2019-20. The Weighted Pupil Unit grow rate is 0.3% over the forecast period. The forecast period also anticipates growth in the South Carolina Public Charter School district to outpace the overall growth rate in school district Weighted Pupil Units. This is due to enrollment growth in existing and new charter schools and the addition of grade levels offered. The Base Student Cost and Weighted Pupil Units for the projected period are:
  - FY 2017-18
    - $2,464
    - 976,493
  - FY 2018-19
    - $2,526
    - 979,416
  - FY 2019-20
    - $2,589
    - 982,347

  The incremental adjustments for the three-year period are $61.2 million, $68.7 million, and $72.3 million, respectively.

MEDICAID AND HEALTH

- **Medicaid Program** – In 2010, the General Assembly increased the state's cigarette tax by fifty cents. The annual revenue from the increase is dedicated to the Medicaid program. During FY 2016-17, $122.2 million of cigarette tax revenue will be used to support the Medicaid program. The cigarette tax revenue dedicated to Medicaid is estimated to be $121 million in FY 2017-18. The Medicaid expenditure estimates on Page 1 are adjusted to reflect this dedicated source of revenue.

  The Medicaid projections reflect additional state funds needed to maintain current service levels based on enrollment and cost per member projections. These increases are primarily attributable to growth in existing programs, as well as increases in both federally mandated Medicare premiums assistance programs and in pharmaceutical expenditures related to the treatment of Hepatitis C.

  The South Carolina Department of Health and Human Services also anticipates continued growth in the Community Long Term Care waiver program, which provides nursing facility level care in patient's homes. This avoids or delays the need for placement in a nursing home. The department is also expecting expenditure growth from Autism Spectrum Disorder related treatment services. Demand for medically necessary diagnostic and treatment services for children under the age of 21 has increased and is expected to continue that trend into the future. These services were added to the State Plan for children under the age of 21 in response to guidance from the Centers for Medicare and Medicaid services and are currently provided through the Early and Periodic Screening, Diagnostic, and Treatment benefit. The projected General Fund growth rate for the Medicaid program is 4.0% for FY 2017-18, 3.4% for FY 2018-19 and 4.7% for FY 2019-20.

  The total additional recurring state appropriations needed to provide sustainable funding for the current Medicaid program for FY 2017-18 thru FY 2019-20 is $159.80 million. The incremental adjustments for FY 2017-18, FY 2018-19, and FY 2019-20 are $51.3 million, $44.7 million, and $63.9 million, respectively.

- **Department of Mental Health** – To continue to cover operating costs at Community Mental Health Centers and inpatient facilities along with population growth in the Forensic Inpatient Services and the Sexually Violent Predators programs, additional funding of $6.5 million will be required in each year for FY 2017-18 through FY 2019-20.

SOCIAL SERVICES AND CORRECTIONAL AGENCIES

- **Department of Social Services – Consent Agreement/Child and Family Service Review** - Funding is required to prepare for two major reforms. The first is the settlement agreement that was the result of the federal class action lawsuit Michelle H. v. Haley, et.al. The agreement requires the agency to meet a number of benchmarks to reform the child welfare system. These benchmarks include: achieving and maintaining caseload standards approved by the court, increasing the number and quality of foster care options, and creating a foster health care system that is tailored to the needs of children in the foster care system. The agency must also prepare for a federal review of the quality of the state's delivery of child welfare services. States that are not in substantial compliance with federal requirements are required to create plans to improve deficiencies. Failure to implement the improvement plans will result in significant federal financial penalties. The expected recurring costs of these two reforms is $19.7 million.

- **Child Support Enforcement Statewide Automated System Development** – Funding is required for the continued development and implementation of a federally mandated statewide automated system for Child Support Enforcement, as well as to pay for penalties currently imposed on the state by the federal government. The estimated cost is $25 million per year over the forecast period.

HIGHER EDUCATION SCHOLARSHIP GROWTH

- **LIFE, HOPE & Palmetto Fellows Scholarships** – The estimate for FY 2017-18 through FY 2019-20 assumes five-year average enrollment growth rates of 2.5%, 3.7% and 3.6% for LIFE, HOPE and Palmetto Fellows scholarships, respectively. Also, beginning in the 2016-17 school year the South Carolina Department of Education revised the state's Uniform Grading Policy. This revision led to the transition from a 7 to 10-point grading scale. The change will result in more students becoming eligible for higher education funding through state scholarship programs.

  The estimated incremental costs for the three scholarship programs are $21.1 million in FY 2017-18, $14.5 million in FY 2018-19, and $12.8 million in FY 2019-20. These incremental cost estimates take into account both the anticipated costs of changes to the Uniform Grading Policy and continued growth at the five-year average rate for each scholarship program.

DEPARTMENT OF TRANSPORTATION

- **Non-Federal Highway Aid** – Funding is required to annualize non-recurring appropriations made in FY 2016-17 meant to replace the sales tax on cars revenue stream that was shifted from this program as part of the roads funding portion of Act 275 of 2016. The Non-Federal Highway Fund is used to maintain and improve the state's secondary roads, which are not eligible for federal aid. The recurring annualization is $50 million in FY 2017-18.

STATE EMPLOYEE HEALTH PLAN

- Retiree Growth and Rate Increase – The South Carolina Public Employee Benefit Authority (PEBA) estimates the General Fund amounts needed for the operation of the State Health Plan for retiree growth and health plan increases are as follows:

  1. Retiree Growth and Rate Increase
     a. Calendar Year 2017 employer base (state funds only) is $867,312,536;

   b. Annualization involves funding the final six months (Jul-Dec) of an increase that is effective the prior January;
   c. The employer rate increase involves funding the first six months (Jan-Jun) of an increase that is effective January of the fiscal year; and
   d. The projected annual premium growth rate effective each year equals 3.5% in January 2018, 8.5% in January 2019 and 9.5% in January 2020.
2. The projection assumes the employer pays the same proportion that is in place in January 2017 for 2018, 2019, and 2020;
3. Retiree growth for FY 2017-18 through FY 2019-20 is estimated at 2.4% per year.
4. The estimated amount of additional general fund dollars for the State Health Plan is $26.5 million in FY 2017-18, $63.9 million in FY 2018-19, and $100.4 million in FY 2019-20.

STATE EMPLOYEE COMPENSATION

❖ The estimate is based on total State Employee salary, with the exception of exempted groups (Agency Heads, Members of the Legislature, and Constitutional Officers), plus other included groups (Local Health Care Providers, County Auditors and Treasurers, and School Bus Drivers). The cost for a two percent increase equals approximately $36.4 million per year to include all applicable fringe benefits.

HURRICANE MATTHEW

❖ Hurricane Matthew made landfall in South Carolina as a Category 1 hurricane in October of 2016, and caused an estimated $341 million in damage to public property. Federal programs will cover the majority of these costs, but the FY 2017-18 Executive Budget will include $64 million to cover the state's portion of costs. The South Carolina Emergency Management Division estimates this amount of funding is needed for repair to state roads, public buildings and infrastructure, for debris removal and the cost of emergency protective procedures including evacuations.

STATE EMPLOYEE RETIREMENT SYSTEM

- Required contributions to the state employee, school district, and police retirement system (SCRS and PORS) were raised 50 basis points on both the employee and employer in 2016. The General Assembly also created the Joint Committee on Pension Systems Review to study and make recommendations to address the unfunded liabilities that continue to exist within the SCRS and PORS. If future contribution increases are required, for every 0.5% increase in employer contributions (50 basis points) the impact on the general fund's portion of the increase is estimated at $19 million.

OTHER POST EMPLOYMENT BENEFITS (OPEB)

- Beginning with the FY 2007-08 Comprehensive Annual Financial Report (CAFR), the state implemented the reporting requirements of the Government Accounting Standards Board (GASB) Statement #43 and #45 pertaining to other post-employment benefits (OPEB). GASB does not require funding an entity's OPEB obligations, but only to calculate and report these obligations. Currently, the health insurance benefit for retirees is primarily on a pay-as-you-go basis with this cost included in the FY 2016-17 "base" operating budget.

- The state's unfunded liability with regard to OPEB is estimated at $9.9 billion with $4.5 billion of the liability for State Employees and $5.4 billion for School District Employees. Act 195 of 2008 created the South Carolina Retiree Health Insurance Trust Fund to accumulate sufficient funds to provide post-employment health insurance benefits for retired state and school district employees. The Three-Year General Fund Financial Outlook does not include funding projections beyond the pay-as-you-go basis included in the FY 2016-17 operating budget.